

**IN THE CHANCERY COURT FOR LEWIS COUNTY
AT HOHENWALD, TENNESSEE**

IN RE:

SENTINEL TRUST COMPANY

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) Case No. 4781 (R.E.L.D.)
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**MEMORANDUM IN SUPPORT OF THIRD PARTY CHAMBER
HEALTH CARE SOCIETY, INCORPORATED'S EMERGENCY
MOTION FOR AN ORDER REQUIRING RECEIVER TO
WAIVE WAITING PERIOD TO PERMIT REDEMPTION OF BONDS**

COMES NOW Chamber Health Care Society, Incorporated ("Chamber"), a third party to the above-captioned matter, and hereby makes and files this memorandum in support of its Motion for an Order Requiring Receiver to Waive Waiting Period to Permit Redemption of Bonds (the "Motion"). Chamber respectfully shows the Court as follows:

PRELIMINARY STATEMENT

In this Motion, Chamber requests that the Court waive strict compliance with a trust indenture requiring a 90-day waiting period prior to paying off certain bondholders of a nursing home facility located in Newton County, Georgia. As shown in detail below, the waiver of this provision will permit the closing of a proposed sale of this facility, thereby repaying the bondholders virtually immediately. Failure to waive strict compliance of this provision in the trust indenture threatens the possibility that the sale will take place, causing further damage to Chamber and to the bondholders.

Chamber is the obligor under those certain \$5,110,000 Newton County Industrial Development Authority Qualified 501(c)(3) Bonds (Health Scholarship, Inc. Project Series 1989A) (the "Riverside Bonds"), which are secured by a first priority deed to secure debt on a nursing home facility located in Covington, Newton County, Georgia called the Riverside

Nursing Home ("Riverside" or the "Facility"). Sentinel Trust Company ("Sentinel") serves as the trustee for the Riverside Bonds, and Sentinel is currently in Receivership. Chamber seeks to sell Riverside to West Street Associates, LLC ("West Street"), and the parties have set a closing date of August 1, 2004. The purchase price to be paid by West Street is equal to the principal and interest due the bondholders under the Riverside Bond documents. The purchase price does not exceed the fair market value of the Facility.

The indenture of trust (the "Indenture") contains a 90-day "waiting period" applicable only in a situation where the purchase price (and funds ultimately distributed to bondholders) would exceed the fair market value of the Facility. In similar transactions (i.e., where the purchase price did not exceed the value of the facility) involving identical language, Sentinel has relied upon an opinion of bond counsel and waived the 90-day waiting period. The present sale is being jeopardized by the Receiver's refusal to acknowledge the inapplicability of the 90-day waiting period to the proposed transaction and to grant a waiver of the waiting period as Sentinel has done in the past. The closing of the proposed sale of Riverside would benefit the bondholders, which would receive one hundred percent of the principal and accrued interest due under the Riverside Bond documents.

Enforcement of the waiting period provision will jeopardize the pending transaction with West Street.¹ The Receiver has advised Chamber that more than \$350,000 that was to have been held by Sentinel in a debt service reserve account and a principal and interest account under the terms of the Indenture will not be available for distribution to the Riverside bondholders because

¹ If the West Side sale does not close, any potential subsequent purchaser would likely raise the same issues.

of an overall fiduciary cash short fall within all such accounts that were to have been maintained by Sentinel.

If the waiting period is enforced, Chamber and West Side will be forced to decide between terminating the purchase agreement or paying "double interest" for 120 days (90 day waiting period plus a 30 day notice period to pay the bondholders). That is, West Side would begin paying interest on funds borrowed to acquire the Facility and placed with the Receiver, while at the same time interest would continue to accrue on the Riverside Bonds. With the interest accruing on the Riverside Bonds at the rate of \$1,229.63 per day, the transaction cost will be an additional \$147,555.60 – on top of the additional \$356,603.91 lost as a result of Sentinel's failure to maintain the accounts referenced above.

In this case, the waiting period should be waived because (a) the purpose of the waiting period is inapplicable to these circumstances, as made clear in the accompanying Affidavit of R. Chix Miller, Esquire, the bond counsel in the underlying transaction; (b) Sentinel already is in breach of the Indenture and has harmed Chamber and the bondholders significantly by failing to maintain the required accounts; (c) the sale is threatened by the delay and the increased costs caused by such a delay, causing additional harm to Chamber and its bondholders; (d) there is no guarantee that the bondholders otherwise would be fully paid if the West Side sale does not go through; and (e) the redemption of the bonds is completely in line with the Commissioner's (as defined below) policy of winding up the affairs of Sentinel.

By this Motion, Chamber respectfully requests this Court to exercise its equitable powers and compel the Receiver to waive the waiting period that, under the present circumstances, will serve no purpose but to disrupt a transaction that is in the best interest to all parties to the bond issuance. It is simply fundamentally unfair to hold Chamber in strict compliance with the

contractual waiting period in the Indenture (a waiting period which is not applicable to the West Side sale) while at the same time Sentinel is in material breach of the Indenture for failing to maintain proper accounts.

STATEMENT OF FACTS

I. THE RECEIVERSHIP

Sentinel is a Tennessee corporation engaged in fiduciary activities and subject to regulation by the Commissioner of the Tennessee Department of Financial Institutions (the "Commissioner") under the Tennessee Banking Act. Tenn. Code Ann. § 45-1-124. On May 3, 2004, the Commissioner issued an Emergency Order and Notice of Charges directing Sentinel to cease and desist from engaging in unsafe and unsound banking practices. That Order found that (1) Sentinel had used pooled fiduciary funds to provide operating capital for non-related defaulted bond issues, thereby creating a fiduciary cash shortfall that greatly exceeds Sentinel's current operating capital; (2) Sentinel had failed to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion; and (3) Sentinel had failed to keep accurate books and records.

On May 18, 2004, the Commissioner took emergency possession of Sentinel and appointed Receivership Management, Inc. as the Receiver for Sentinel. Since taking possession of Sentinel, the Commissioner, through his staff and the appointed Receiver, has determined that Sentinel had a fiduciary cash shortfall of an amount ranging from \$7,612,218 to \$8,427,122, as of May, 18, 2004, the date of possession. Accordingly, on June 18, 2004, the Commissioner gave notice of his intent to liquidate Sentinel.

II. THE RIVERSIDE BONDS

A. The Riverside Bond Issuance

In connection with the construction and operation of the Riverside facility in 1989, the Newton County, Georgia Industrial Development Authority issued the Riverside Bonds in the principal amount of \$5,110,000. A copy of excerpts of the Riverside Trust Indenture are attached to the Affidavit of William R. Hill as Exhibit A. In accordance with the terms of the Indenture, the Riverside Bonds were administered through a trust. Sentinel eventually was appointed as trustee (the "Riverside Trustee"), and the bondholders (the "Riverside Bondholders"), are the beneficiaries of the trust. Hill Affidavit at ¶ 4.

Chamber succeeded Health Scholarships Inc. as owner of the Facility and as obligor under the Riverside Bonds. As of June 16, 2004, the principal amount due under the Riverside Bonds is approximately \$4,540,000.00. Affidavit of R. Chix Miller at ¶ 8.

The Indenture requires Sentinel to maintain fiduciary accounts for repayment of the Riverside Bonds and for administration of the repayment process. For example:

Moneys to Be Held in Trust. All moneys paid over to the Trustee for the account of the Bond Fund (to be held in the general account of the special account) under any provision hereof shall be held (subject to the provisions of section 508) in trust by the Trustee for the benefit of the holders of the Bonds entitled to be paid therefrom.

Indenture at Section 507. Sentinel maintained the following fiduciary accounts under the Indenture: (1) Principal and Interest Account (Account Number 465256010 Newton County, Georgia 1989 Bond Fund) (the "Principal Account") and (2) Debt Service Reserve Fund (Account Number 465256011 Newton County, Georgia 1989 DSR Fund) (the "Debt Service Account"). According to Chamber's records, as of July 14, 2004, the balances of the Principal

Account and the Debt Service Account were \$237,124.03 and \$119,479.88, respectively, totaling \$356,603.91. Hill Affidavit at ¶ 5.

In plain breach of Sentinel's contractual obligations under Section 507, the Receiver has advised Chamber that these funds would not be available for redemption of the Riverside Bonds. Accordingly, Chamber and/or the Riverside Bondholders stand to lose at least \$356,603.91 as a result of Sentinel's mismanagement.

B. The Early Redemption Provision

Under the Indenture, Chamber may redeem the Riverside Bonds before their maturity date. If Chamber does so elect, a strict application of the Agreement permits the Riverside Trustee to require Chamber to advance the full principal and accrued interest amount of the Riverside Bonds to the Riverside Trustee to hold in trust for ninety days. The Riverside Trustee is then obligated to provide thirty-days notice to the bondholders, after which time the Riverside Trustee would pay the redemption funds to the bondholders in full satisfaction of the bonds. The Indenture states as follows:

The Bonds are subject to redemption prior to maturity, at any time on or after August 1, 1999, in whole but not in part, at the redemption prices (expressed as percentages of principal amount) set forth in the table below plus accrued interest or interest due thereon on such redemption date; provided that the Borrower furnishes the bondholders with a certificate prior to redemption that no preferences have been advanced within the ninety (90) day period prior to such redemption; and provided further that the Trustee furnishes the bondholders with written notice of such optional redemption in which the Trustee certifies that it has sufficient funds available (funds which have been on deposit with the Trustee for at least ninety (90) days prior to such notice, during which ninety (90) days no preferences have been advanced and no Act of Bankruptcy as defined in this Indenture has occurred), to pay the full redemption price.

Miller Affidavit, Exhibit A, Indenture (the "Early Redemption Provision").

Generally, the purpose of the ninety-day waiting period is to avoid the possibility that a bankruptcy trustee would seek to undo the bond redemption under section 547 of the Bankruptcy Code, 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"). Section 547 of the Bankruptcy Code empowers a bankruptcy trustee to avoid certain transfers made within ninety days before the bankruptcy filing if such transfer had the effect of diminishing the value of the estate to the detriment of other creditors. As will be discussed in greater detail below, Chamber has entered an agreement for the sale of the Facility that would eliminate any possibility that Chamber's redemption of the Riverside Bonds could result in any preference liability under section 547 of the Bankruptcy Code. Miller Affidavit at ¶¶ 8-9. Therefore, the Early Redemption Provision waiting period could be waived without any possibility of a preference claim being made with respect to payments made to the bondholders. Before the institution of the Sentinel Receivership, Sentinel had waived this waiting period when, like here, the waiting period serves no purpose as a result of the fact that there is no preference liability. *Id.* at ¶¶ 3-7.

III. AGREEMENT TO SELL THE FACILITY

Chamber and West Street have entered into an agreement in principle (the "Proposed Agreement") for the purchase and sale of the Facility. Under the Proposed Agreement, West Street would pay Chamber a purchase price equal to the outstanding principal and accrued interest due under the Riverside Bonds, plus certain bond-related costs, and Chamber would exercise the Early Redemption Provision and redeem the Riverside Bonds by paying the bondholders the full principal and accrued interest amounts. Upon payment of such amounts, the security documents collateralizing the Riverside Bonds would be released.

The Early Redemption Provision, however, poses a significant barrier to the closing of the Proposed Agreement. First, the 120-day waiting period (ninety-day retention of funds, plus thirty-day notice period) would significantly delay payment under the Riverside Bonds, thereby

causing additional and unnecessary interest liabilities on the outstanding principal. The Receiver has indicated that interest would accrue at a rate of no less than \$1,229.63 per day. Id. at ¶ 8.

Second, the bond redemption money (an amount equal to the current principal balance of the Riverside Bonds, plus one-hundred and twenty days' interest and certain bond-related costs) would remain in a trust account with the Receiver for one-hundred and twenty days and earn only a nominal (i.e. money market) rate of interest. Thus, the effect of this Early Redemption Provision waiting period is to require that (i) interest continue to accrue on the Bonds for 120 days at \$1,229.63, a total of \$147,555.60; (ii) West Side pay interest to its lender for funds borrowed to close the transaction during that same 120 day period; and (iii) payment to bondholders be delayed. These costs would be in addition to the more than \$356,603.91 that Sentinel was obligated to hold for the benefit of Chamber and the bondholders, but that is now unavailable due to Sentinel's mismanagement.

Chamber is now concerned that the Proposed Agreement will not close on August 1, 2004 and may not close at all. Hill Affidavit at ¶ 9. The loss of \$356,603.91 combined with the risk and additional expense associated with the waiting period have the overall effect of seriously jeopardizing the proposed sale. Chamber therefore approached the Receiver and requested that the Receiver waive the ninety-day waiting period and thirty-day notice period for several reasons: (a) the bondholders would benefit greatly by being repaid the full principal and accrued interest amount of the Riverside Bonds as soon as possible; and (b) the primary purpose of the ninety-day waiting period – to reduce the risk of a lawsuit under section 547 of the Bankruptcy Code – would not be implicated by the proposed payment arrangement and is therefore unnecessary. Despite Sentinel's willingness to waive similar provisions under similar circumstances in the past, the Receiver has declined to waive the Early Redemption Provision

waiting period. Affidavit of Miller, ¶ 10. In doing so, the Receiver jeopardizes the Proposed Agreement and the full payment to the bondholders of the amounts due under the Riverside Bonds.

ARGUMENT AND CITATION OF AUTHORITIES

I. THE COURT SHOULD REQUIRE THE RECEIVER TO WAIVE THE NINETY- DAY WAITING PERIOD AND THE THIRTY-DAY NOTICE PERIOD.

A. Both the Receiver and the Bondholders Would Be Helped – Not Harmed – By a Waiver of the Early Redemption Provision Waiting Period.

An examination of how the Bankruptcy Code's preference statute works demonstrates why strict enforcement of the ninety-day waiting period is detrimental to the interests of the Riverside Bondholders and Chamber, with no tangible benefits for any other party. Generally, a trustee may avoid transfers made within ninety days of the bankruptcy filing that both diminish the estate and would allow the creditor to receive more than it otherwise would receive in a hypothetical liquidation case.²

As an initial matter, Chamber is not insolvent, nor would it be made insolvent by redeeming the Riverside Bonds if it were to sell the Facility pursuant to the Proposed Agreement. Hill Affidavit at ¶ 10. Accordingly, there is little risk that the Early Redemption Provision

² Section 547(b) of the Bankruptcy Code states in relevant part:

[T]he trustee may avoid any transfer of an interest of the debtor in property -
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made - (A) on or within 90 days before the date of the filing of the petition; or
(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if -
(A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

would ever become an issue because the provision serves to protect against bankruptcy preference actions. More importantly, Chamber's redemption under the circumstances would not be a preference because the bondholders' claims are fully secured. Miller Affidavit at ¶¶ 8-9. Therefore, the bondholders would receive the exact same amount in a hypothetical liquidation because security interests generally are not affected by a bankruptcy.

The Early Redemption Provision waiting period would only be applicable in a scenario where the redemption payment to the bondholders would be higher than the value of the Facility. The payment, therefore, could fall under the preference provisions as payment of a partially unsecured claim because, under that unique scenario, the value of the collateral (i.e., the Facility) would be less than the amount of the claim, and the bondholders would be undersecured. In that situation, if Chamber filed for bankruptcy, the trustee would argue that the bondholders may receive less than full payment on their bonds in a hypothetical liquidation because they would only be entitled to payment equal to the value of their collateral.

But that is not the case here. The Proposed Agreement precludes the possibility that the bondholders would ever be undersecured because the sale price is the principal and accrued interest due under the Riverside Bonds. Moreover, the fair market value of the Facility actually exceeds the principal amount. Miller Affidavit at ¶8; Hill Affidavit at ¶8; Rees Affidavit at ¶¶ 4-5. Thus, in a hypothetical liquidation, the bondholders would receive the same amount as they would under the Proposed Agreement, and the hypothetical bankruptcy trustee would be unable to establish an essential element of its claim – that the bondholders would have received less in a liquidation. As a result, the 90-day waiting period serves no purpose.

Sentinel has already demonstrated a troubling failure to comply with its fiduciary obligations and appears to have squandered literally millions of dollars of fiduciary funds. To

force Chamber to provide additional money to Sentinel, which has already lost millions of dollars through mismanagement and cannot live up to its current contractual commitments under the Indenture, is costly and imposes a serious risk on the transaction.

B. The Court Should Exercise its Equitable Powers to Avoid the Unnecessary Prejudice that all Parties to the Bond Issuance Would Suffer if the Ninety-Day Waiting Period Were not Waived.

It is well recognized in Tennessee that Chancery Courts have the discretion to refuse to enforce an agreement or a particular term of an agreement when enforcement would be harsh, inequitable or oppressive. See e.g. Dyersburg Machine Works, Inc. v. Retenbach Engineering Company, 650 S.W.2d 378, 380-81 (Tenn. 1983) (Supreme Court upheld Chancery Court's refusal to enforce a forum selection clause in a contract because enforcement would have been unfair and inequitable); Philson v. Jackson, 1993 WL 414838 *7 (Tenn. Ct. App. Oct. 20, 1993) (copy attached) (Court of Appeals upheld Chancery Court's finding of "special circumstances" that warranted waiving notice requirement to renew a lease) (quoting Corim, Inc. v. Sam Blair Co., 721 S.W.2d 256, 261 (Tenn. Ct. App. 1986)); Ring v. Jehl, 421 S.W.2d 375, 566-68 (Tenn. Ct. App. 1967) (Court of Appeals affirms Chancery Court's refusal to grant specific performance of a contract where enforcement would be harsh, inequitable and oppressive even if the contract may be valid and enforceable at law).

Enforcement of the waiting period could jeopardize the sale of the Facility, which could result in substantial harm to all parties involved. As noted above, the Early Redemption Provision would have the effect of requiring the payment of double interest on more than \$4.5 million for an additional 120 days. As a result, over a period of four months, the added interest costs would increase the purchase price unnecessarily by at least \$147,555.60, thereby impairing the abilities of Chamber and West Street to close the deal.

In addition to the costs associated with the waiting period, approximately \$356,603.91 that should have been available for payment of bond obligations currently is unavailable due to Sentinel's breach of its obligations under the Indenture and mismanagement of pooled fiduciary accounts. While the Proposed Agreement will resolve that shortfall in the case of the Riverside Bonds (as the bondholders would be paid in full), the closing of the Proposed Agreement is jeopardized by the fact that not only is there a \$356,603.91 shortfall due to Sentinel's mismanagement, but also by the fact that unnecessary costs of \$147,555.60 are being added to the transaction as a result of the waiting period.

This is the exact type of situation that Chancery courts have relieved through exercise of their equitable powers. See, e.g., Philson, 1993 WL 414838 at *7 (finding "special circumstances" to warrant relief from contractual obligation).³ In light of Sentinel's wrongdoing, this case presents an even stronger argument for the Court's use of its equitable powers.

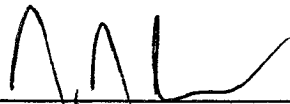
CONCLUSION

Based on the foregoing, Chamber respectfully requests this Court to exercise its equitable powers in providing the parties a just and reasonable solution. Chamber requests that this Court enter an order substantially in the form as the proposed order attached to the Motion, requiring the Receiver to waive the Early Redemption Provision.

³ In Philson, the plaintiff sought to renew the lease on his restaurant, but delivered his notice of intent to renew twenty-one days after the deadline set by the lease agreement. Id. at *1-2. He requested a declaratory judgment relieving him from the obligation to give timely notice as a condition to renewing the lease. Id. The court found that the plaintiff would suffer unconscionable hardship if the lease was not renewed because he had operated a restaurant in the same location for twenty years as his sole source of income, had invested heavily in improving the premises, and because there was no reasonable replacement location. Id. at *8.

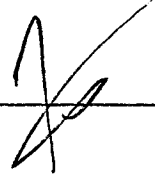
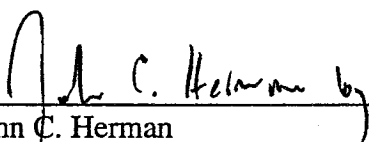
Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that I have this day served all parties in the foregoing matter with the foregoing MEMORANDUM IN SUPPORT OF EMERGENCY MOTION OF THIRD PARTY CHAMBER HEALTH CARE SOCIETY, INCORPORATED FOR AN ORDER REQUIRING RECEIVER TO WAIVE WAITING PERIOD TO PERMIT REDEMPTION OF BONDS by United States mail on counsel of record as follows:

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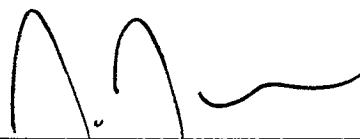
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This 20th day of July, 2004.



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